

INTRODUCTION

In 1976, the first tax law offering incentives to developers of historic property was passed and entered into the Internal Revenue Code. The Tax Reform Act of 1976 established accelerated depreciation for the rehabilitation of depreciable historic properties. Disincentives for demolition of historic properties were also enacted at that time. The Revenue Act of 1978 and the Tax Treatment Extension Act of 1980 expanded these tax treatments.

It was, however, the Economic Recovery Tax Act (ERTA) of 1981, effective January 1, 1982, which dramatically changed the federal tax treatment of investment in real estate. This law, among other things, repealed the previous incentives and replaced them with a three-tiered investment tax credit (ITC) for rehabilitation of historic buildings and building 30 years or older. It is the enactment of ERTA that has served as a significant stimulus to the preservation and rehabilitation of the architectural heritage of this country. In addition to the ITC, the cost recovery period for all real estate was shortened to 15 years, component depreciation was eliminated and the owners of certified rehabilitated historic properties were allowed 100 percent depreciation of rehabilitation expenses after the tax credit was taken.

The Tax Equity and Fiscal Responsibility Act (TEFRA) of 1982, effective January 1, 1983, amended ERTA in several areas. The amendment which most directly affects historic rehabilitation is the requirement to reduce the adjusted basis of a property by one-half of the ITC. Although this amendment reduc-

ed the incentives, the law still favors rehabilitation of historic properties over new construction.

Finally, on July 18, 1984, the Tax Reform Act of 1984 was signed into law, amending ERTA. The ITC remains intact, but the following changes will directly affect historic rehabilitation:

The 15-year accelerated cost recovery system (ACRS) was replaced with an 18-year schedule.

Properties in "tax-exempt use," allowed by TEFRA, have been significantly penalized. (See Tax-Exempt Use in a following section.)

An alternative "wall test" was approved to supplement the existing requirement that 75 percent of the external walls be retained. (See The Wall Test in a following section.)

The demolition disincentive, which denies deductions for the cost of demolition of historic buildings, was expanded to include all buildings.

The following information on the ITC and the certification process is intended to be used as a guide by individuals interested in the development of historic properties. It is advisable for the user of this booklet to consult legal counsel, or an accountant familiar with the preservation tax incentives. In some cases, transition rules, effective dates and exceptions to the law may play a vital role in the success of a project. This publication does not attempt to address these very specific and detailed issues.

THE INVESTMENT TAX CREDIT

The Investment Tax Credit (ITC) is available for the qualified rehabilitation of older and historic structures on a three-tiered system. Non-residential structures 30 years old or older may qualify for a 15 percent ITC. Non-residential structures 40 years old or older may qualify for a 20 percent ITC. Certified historic structures, both residential and non-residential, may qualify for a 25 percent ITC. The credit is applied to rehabilitation expenditures only and may be carried back as many as 3 years or forward as many as 15 years.

In order to qualify for a 15 percent or 20 percent ITC, a building must be depreciable (non-residential only), substantially rehabilitated, and 75 percent of the external walls must be retained. (See a later section on The Wall Test.) In order for a 30 or 40-year-old building within a National Register district to qualify for the 15 or 20 percent ITC, it must first be certified by the Department of the Interior as a non-contributing element to that district. In rare instances, a building of less than 50 years of age may positively contribute to the National Register district within which it is located. If this is the case, the building would then be considered historic and would qualify for the 25 percent ITC. Contributing structures within registered historic districts are confined to the 25 percent category and will not qualify for a lesser tax credit.

The 25 percent ITC is available to certified historic buildings which are depreciable (residential and non-residential) and are substantially rehabilitated. As long as 75 percent of the external walls are retained and the rehabilitation is certified by the Department of the Interior as being consistent with the historic character of the building.